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SUBJECT: PRESIDENT DECLARES "WAR" ON FOREIGN TOBACCO BUYERS

REF: LILONGWE 275

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¶1. (U) Summary: President Mutharika has again lashed out at foreign tobacco buyers, castigating them for paying low prices at the state-run auction. The president singled out for criticism the manager of the local subsidiary of an American tobacco company, telling him to pay more or leave the country. Buyers reacted nervously, concerned that the strong rhetoric will scare away international customers and damage Malawi's weak investment climate. End summary.

Declaration of "War"

¶2. (U) In a reprise of his fiery performance at the opening of tobacco season in March (reftel), President Mutharika has again attacked foreign tobacco buyers over the low prices that Malawi's smallholder farmers are receiving at the state-run auction. In a speech opening the annual Agricultural Fair in Blantyre on August 10, Mutharika accused the buyers of "stealing from us" and "exploiting us" by paying low prices at the auction.

¶3. (U) The president focused his criticism on the manager of Limbe Leaf, the local subsidiary of American tobacco company Universal Leaf. Mutharika declared the manager "and his cohorts" should pay higher prices or leave the country, eliciting a roar of approval from the crowd. The president continued, "this is my home and it's not their home. So, someone has to leave, and the person who will leave is not me."

¶4. (U) Ratcheting up the tone, Mutharika bellowed, "This is war. And in any war, of course there are casualties. I'd like them to stay, but they are not going to stay on their terms. They will stay on my terms."

Tough Words Won't Fix the Problem

¶5. (U) Malawi tobacco prices are depressed for a number of reasons, primarily relating to basic supply and demand. Thanks to good rains and GOM fertilizer subsidies, the country has produced a record tobacco crop of approximately 158,000 MT this year. Production has risen steadily in the past 10 years

since the liberalization of the sector in the mid-1990s. Prior to that time, tobacco production was strictly limited by law under the Banda-era Special Crops Act. Under that law, permits were issued to friends of the regime who grew tobacco on large estates. Production quantity was controlled, quality was good, and prices were high. Since the abolition of the act and the liberalization of the sector, some 400,000 smallholder farmers have entered the market, steadily increasing the quantity of tobacco produced, while the overall quality has fallen. At the same time, global demand for tobacco has been flat.

¶6. (U) A further problem is the inefficient method by which smallholder tobacco is sold through the government-owned auction, with several parastatal agencies taking their cut of farmers' meager profits. Smallholders must also pay steep fees for transporting their product to market, and for warehousing it at the auction. Operators of larger farms who grow tobacco on contract (thereby avoiding the auction) do command higher prices. But the vast majority of producers are trapped in the auction system. The GOM is, of course, reluctant to change a system that provides considerable revenue and a large number of patronage jobs.

¶7. (U) With all of these factors, it is easy to see why Malawian smallholders are not commanding the kind of prices they would wish for. For several years now, most small farmers have only been able to break even growing tobacco.

Buyer Reaction

¶8. (SBU) Local tobacco company executives told us the reaction to Mutharika's speech was swift, and they received calls the next day from nervous customers as far away as the U.S. and Japan. One local buyer was hosting a group of overseas clients who decided to cut short their visit and depart,

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fearful of public reaction to the speech. Buyers are anxious, and concerned that the president's remarks will prompt another disruption in the market, as happened earlier in the season. Following Mutharika's earlier outburst in March, sales volumes at the auction in the first two months of the season were seriously depressed, and foreign exchange income fell precipitously. Since June, sales have increased as the market settled down, and record volumes have compensated for the lower average prices.

Comment

¶9. (SBU) Mutharika's remarks on this and other occasions reveal a basic misunderstanding of the global tobacco market and the impediments to smallholder tobacco production in Malawi. His attack on Limbe Leaf is particularly curious, since the majority shareholder in the company is the locally-owned Press Corporation, and a large portion of Press is owned by none other than the Government of Malawi (American company Universal Leaf owns less than 50 percent of Limbe).

¶10. (SBU) Mutharika's tough talk may go down well with the masses, but the message to investors, both domestic and foreign, is more ominous. Many local and foreign business people have told us of their fears that, with such an attitude, the GOM might arbitrarily decide to change the terms of contracts or nationalize assets.

¶11. (SBU) In the case of tobacco, the president is taking a particular risk in attacking the foreign buyers. Both of the major foreign buyers, Universal and Alliance One, have large investments and spare capacity elsewhere. Universal has expanded its operations in Mozambique in recent years, and company executives have told us that their new processing plant in Mozambique has room for expansion. Malawi is also competing against low-cost, high-efficiency producers like

Brazil. If the GOM continues to show a hostile attitude, those companies might well look to expand their operations elsewhere. With 60 percent of the country's foreign exchange income derived from tobacco, Mutharika is taking a gamble that, if he loses, could see a sizeable chunk of the Malawi economy go up in smoke.

EASTHAM